II ECONOMIC AND MARKET CONSIDERATIONS THAT SHOULD GUIDE THE COMMISSION'S CONSIDERATION OF BA-NY'S UNE COST CLAIMS.

Q. CAN YOU FURTHER ELABORATE ON THE PURPOSE OF THIS SECTION OF THE REPLY TESTIMONY?

A. Yes. Engineering-based costing models are an important and useful tool in assessing network element costs. Certainly, the results of such models will be important in the current proceeding. It is essential, however, that the outcomes of such models be reviewed within the appropriate economic context to ensure their validity. Economic theory tells us a great deal about what we should expect regarding costs, prices, and related firm behaviors. It is imperative that costing model results be evaluated within this light. Therefore, the purpose of this section is to examine the UNE prices proposed by BA-NY within the context of the telecommunications markets in which this carrier operates. Through this examination, it should be possible to determine whether or not these proposed prices are consistent with observed telecommunications trends, the previous decisions of this Commission, and the behavior of BA-NY and other local telecommunications providers.

Q. HOW IS THE REMAINDER OF THIS SECTION OF TESTIMONY ORGANIZED?

A. First, it will review the possible economic circumstances that might justify the rather substantial UNE price increases sought by BA-NY in order to determine whether or not the available evidence supports these explanations. Next, it will outline the impacts on both local and long-distance competition of approving these price increases if they are, in fact, unjustified. Finally, it will review the UNE prices proposed by BA-NY within the context of the costing standards that Commission has repeatedly deemed appropriate.

Q. HAVE YOU EVALUATED THE UNE PRICES PROPOSED BY BA-NY IN COMPARISON TO THE PRICES ESTABLISHED BY THE COMMISSION IN 1997?

A. Yes. While BA-NY has proposed lower rates for some UNEs, the majority of its proposed rates are considerably higher than current charges. For example, BA-NY proposes a 28% increase in the monthly loop rate for the major cities zone[2], a 24% increase in the monthly charge for local

[2] BA-NY's proposed monthly major cities loop rate assuming a universal rather than an integrated interface is 59% higher than the current rate. As demonstrated elsewhere in this reply testimony, BA-NY's proposed universal interface-based loop rates should be rejected outright.

switching, and a 754% increase in the non-recurring charge for a UNE-L hot cut. The overall monthly UNE-P or "platform" rate would increase by 12.5%.

Q. ARE THERE ECONOMIC CIRCUMSTANCES THAT WOULD JUSTIFY THE UNE PRICE INCREASES PROPOSED BY BA-NY ?

A. Yes, there are two. First, the price increases proposed by BA-NY are justified if the 1997 prices established by the Commission were miscalculated by the Commission and were, in fact, significantly below the relevant economic costs of supplying network elements. That is to say, if BA-NY, for example, can demonstrate that the efficiently incurred monthly cost of supplying a loop in the major cities zone was (and still is) 28% greater than the $12.49 price established by the Commission in 1997, then the requested price increase for this element is justified. Second, these price increases are justified if the efficiently determined costs of providing these network elements were correctly calculated in 1997, but have increased in subsequent years. So, for example, if the competitively determined monthly cost of supplying local switching in New York has increased by 24% since 1997, then Bell Atlantic's proposed price increase for this element is justified.

Q. IS THERE EVIDENCE THAT THE PRICES ESTABLISHED BY THE COMMISSION IN 1997 WERE TOO LOW?

A. No. The evidence suggests that the UNE prices established in New York were not too low. Economic theory clearly predicts a number of outcomes that might be expected if the prices established by the Commission in 1997 had been lower than the competitively incurred costs of supplying network elements. These include the poor financial performance of the regulated seller (BA-NY), a paucity of local network investment - particularly in those network elements that were under-priced, and a entry into local telephony markets almost exclusively through the purchase of UNEs. None of these outcomes have been observed.

Q. HOW WOULD YOU CHARACTERIZE ENTRY INTO LOCAL NEW YORK TELECOMMUNICATIONS MARKETS?

A. Local New York markets are witnessing considerable market entry relative to other jurisdictions where the process of introducing local competition is more restrained. Moreover, the purchase of unbundled elements and complete UNE platforms appears to be an important part of this process. There are, however, two important points worth noting. First, UNE-based entry, while important, is by no means, the exclusive means of entry. New market entrants are also self-supplying a number of network elements and, in some cases, are electing to serve new customers through the extensive use of their own newly created facilities.

For example, AT&T currently serves New York customers through the purchase of UNE platforms from BA-NY. AT&T, however, also serves small and medium size business customers by supplying critical network facilities itself. If currently sanctioned UNE prices are well below the competitively incurred cost of supply, as BA-NY suggests, new local competitors would be foolish to self-supply *any* network facilities. Secondly, given the relatively large volume of purchases in New York, UNE prices that are as much as 754% below costs would almost certainly result in a serious financial drain on BA-NY.[3] This drain would, in turn, result in a visibly poor financial performance, a lack of investment, or both. We simply have failed to witness this.

Q. HOW WOULD YOU CHARACTERIZE BA-NY's FINANCIAL PERFORMANCE OVER THE PAST THREE YEARS?

A. The available financial statistics indicate that BA-NY's financial performance has been sound over the past three years. Since Bell Atlantic acquired New York Telephone in 1997, the data indicate neither unusual decreases in financial performance nor any decline in profitability. New York Telephone's gross profit margin, and more

[3] The BA-NY proposed non-recurring charge for a UNE-L hot cut is $204.81 in comparison to the currently sanctioned rate of $23.97.

importantly, net profit margin were less than that of Bell Atlantic at the point of acquisition, but have increased greatly from 1998 to 1999. During that time, New York Telephone's gross profit margin nearly doubled from 9.28% to 18.48% while the net profit margin increased from 3.7% to 9.28%. These financial data fail to reveal any indication of below-cost pricing.[4]

Q. HAS BELL ATLANTIC CONTINUED TO INVEST IN LOCAL NETWORK INFRASTRUCTURE IN NEW YORK?

A. Yes it has. Indeed, BA-NY's own experts have indicated its New York investments have be, "at record high levels."[5] During 1999, Bell Atlantic made capital expenditures in New York of approximately $2.2 billion. 1997 and 1998 values were $1.5 billion and $1.8 billion respectively.[6] While not all such expenditures were made for assets that contribute to the provision of UNEs, some certainly were. Indeed, many of these expenditures were made to fully transition local exchange networks from analog to digital.[7]

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[4] See New York Telephone Forms 10-K405, filed March 25, 1998, March 30, 1999, and March 30, 2000, United States Securities and Exchange Commission, Washington, DC.

[5] See testimony of Paula Brown on Behalf of Bell Atlantic - New York, Cases 95-C0657, 94-C-0095, and 91-C-1174, December 22, 1999, p. 17.

[6] See New York Telephone, Forms 10-K405, filed, March 30, 2000, United States Securities and Exchange Commission, Washington, D.C.

[7] *Ibid*

If the UNE prices, established by the Commission in 1997, had been measurably below the efficiently-incurred cost of providing these elements, BA-NY would have almost certainly have lacked the capacity to invest in its network within the State. Moreover, UNE prices that fail to recover efficiently-incurred costs would specifically eliminate any incentive BA-NY might have had to invest in the network elements affected by these prices. Why would any carrier invest new dollars in capacity that it is obligated to re-sell at a loss?[8]

Q. IS IT YOUR JUDGMENT THAT BELL ATLANTIC'S STRONG INVESTMENT IN ITS NEW YORK LOCAL NETWORKS HAS BEEN FORCED BY ITS REQUIREMENT TO SUPPLY UNBUNDLED NETWORK ELEMENTS?

A. No. If anything, Bell Atlantic's decision to invest heavily in New York is largely the result of emerging, yet nascent, competition. In very nearly every network industry in which effective competition has replaced regulatory oversight, firms have responded by increasing their investment in network facilities. One need only look

[8] In this regard, it is worth noting that BA-NY claims to have engaged in a level of investment that even *exceeds* that which it promised in connection with the NYNEX merger. See the testimony of Kevin O'Quin on behalf of Bell Atlantic - New York, Cases 95-C0657, 94-C-0095, and 91-C-1174, December 22, 1999, p. 13.

at AT&T's rate of fiber deployment before and after 1984 or the copious sums railroads have spent to upgrade trackage since their deregulation in 1980 to see the effect that competition has on network investment.[9] Competition places great pressure on firms to provide increasingly dependable and ever more flexible services to their customers. This competitive pressure, in turn, requires an investment response. BA-NY, itself, is clearly cognizant of this relationship. In recent testimony before the Commission, BA-NY witness Paula Brown stated:

> In short, BA-NY is behaving in a way a competitive business should; it is making the investments that are necessary both to maintain and improve service quality, while also making those investments that are necessary to ensure that it is able to meet the expanding needs of its customers throughout the State for new and advanced telecommunication services.[10]

It is likely that BA-NY's investments have also been driven by observable increases in the number of lines it provides. Even though new competitive entrants were capturing some former BA-NY customers, the number of switched access lines

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[9] For example, AT&T expanded its fiber network route miles by nearly 600% between 1985 and 1990. See Jonathan M. Kraushaar, Fiber Deployment Update, Federal Communications Commission, Common Carrier Bureau, Industry Analysis Division, September, 1999, Table 1.

[10] See testimony of Paula Brown on Behalf of Bell Atlantic - New York, Cases 95-C0657, 94-C-0095, and 91-C-1174, December 22, 1999, p. 21.

supplied by BA-NY grew by more than 12% between 1994 and 1998. The explosion in internet use and continued growth in the number of lines dedicated to fax machines, together, have placed pressure on BA-NY to increase the size of its network even if the number of customers it serves falls.

Q. IS THERE ANY EVIDENCE TO SUGGEST THAT BA-NY BELIEVED THAT THE ORIGINAL SET OF PRICES ESTABLISHED BY THE COMMISSION IN 1997 WERE APPROPRIATE, GIVEN THE COSTING STANDARDS IN PLACE?

A. Yes. Within Bell Atlantic's Section 271 proceeding in New York, a variety of parties - including Bell Atlantic - seemed to agree that the UNE prices in effect at that time were appropriate. In its order, the FCC writes:[11]

> We agree with Bell Atlantic's assertion that it has worked with the New York Commission to establish prices for unbundled network elements and that these proceedings "have resulted in a full suite of TELRIC rates."

Clearly, in the relatively recent past and in order to secure Section 271 approval, Bell Atlantic viewed the UNE prices established by the Commission as adhering to the TELRIC standards.

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[11] See *Memorandum and Order*, CC Docket 99-295, Federal Communications Commission, December, 22, 1999, ¶ 238, pp. 129-30.

Q. IF THERE IS NO EVIDENCE THAT THE UNE PRICES ESTABLISHED BY THE COMMISSION WERE TOO LOW, IS THERE EVIDENCE THAT THE EFFICIENTLY INCURRED COST OF SUPPLYING NETWORK ELEMENTS IN NEW YORK HAS INCREASED SIGNIFICANTLY OVER THE PAST THREE YEARS?

A. No. To the contrary, the evidence suggests that the competitively determined cost of supplying UNEs in New York have likely fallen since UNE prices were established in 1997. This evidence is of three kinds. First, data reported by Bell Atlantic to the FCC suggest falling unit costs both generally and within the specific cost categories most easily related to the provision of UNEs. Second, the procedures currently in place for regulating local exchange services in New York also support the notion that costs are falling. Finally, the evidence presented elsewhere in this reply testimony indicates that the competitively incurred cost of supplying certain elements are falling rather than rising.

Q. WHAT DO THE FCC DATA INDICATE?

A. FCC cost data for Bell Atlantic/New York Telephone operations in New York are available though 1999. These data are very instructive. After adjusting for inflation, Bell Atlantic-New York/New York Telephone's (BA-NY) Total Operating Expenses per switched access line fell in all but

one year between 1994 and 1999, producing a total decline of 18.6% over the period. During the same time frame, its central office switching expense per access line fell by 32.7% and its total customer operations expense, calculated in the same fashion, fell by 23.7%.[12] This pattern of falling real costs per access line is, in fact, observable across nearly every cost category for each of Bell Atlantic's state-specific operations.

Q. DOES THE CURRENT REGULATION OF LOCAL TELEPHONE SERVICE IN NEW YORK PROVIDE ANY ADDITIONAL GUIDANCE REGARDING THE INTERTEMPORAL PATH OF UNE COSTS?

A. Yes. New York has adopted a regulatory framework for local exchange that fits within the general category of "incentive regulation" and, like most such regimes, the State's *Performance Regulation Plan* (PRP), embodies the expectation that local service providers will be able to reduce costs over time, so that local rates can be lowered.

[12] For 1994-98, Cost and access line data were developed through the *Statistics of Communications Common Carriers*, Tables 2-9 and 2-10. For 1999, these data were drawn directly from the FCC's ARMIS Data Retrieval System. All cost values were adjusted for inflation based on the Implicit GNP deflator available through the Department of Commerce, Bureau of Economic Analysis.

The PRP contains two specific provisions that attest to the expectation of falling costs.[13] First, the regulatory framework contains a table of expected revenue decreases that is based on reductions in target rates for a variety of BA-NY services. Thus, the PRP explicitly requires increased productivity and lower costs over time. This explicit provision is reinforced by the PRP's treatment of inflation. BA-NY has no mechanism for recovering losses attributable to annual inflation, so long as the value of the Gross Domestic Product Implicit Price Deflator (GDP-IPD) is less than 4%. Thus, in addition to the targeted reductions in rates, BA-NY efficiency gains are expected to keep pace with inflation, so long as that inflation is less than 4%.

Q. WERE THERE EXPECTATIONS REGARDING THE IMPACT OF BELL ATLANTIC'S ACQUISITION OF NYNEX ON SYSTEM COSTS?

A. Yes. Both documents filed within regulatory proceedings and documents distributed to Bell Atlantic shareholders make it clear that Bell Atlantic expected to realize significant operational savings from the merger. Bell Atlantic's 1997 annual report states:

> The merger of Bell Atlantic and NYNEX was completed on August 14, 1997. We are targeting

[13] See, *Performance Regulation Plan for New York Telephone*, State of New York, Public Service Commission, Case 92-C0665, September 28, 1994.

> recurring expense savings of approximately $450 million in 1998, $750 million by 1999 and $1.1 billion by 2000 and approximately $300 million a year in capital savings as a result of the merger by consolidating and integrating networks and operating systems, eliminating approximately 3,100 management positions, centralizing procurement, reducing the need for contract services, consolidating real estate, combining information systems and eliminating duplicative operations. [14]

Moreover, in recent New York testimony, BA-NY claims, "the actual and estimated BA-NY intrastate expense savings from the merger for 1997-2000 are $27 million, $92 million, $150 million, and $220 million respectively."[15]

As with the case of general productivity gains, not all of the savings associated with the NYNEX transaction stem from activities that involve the production of UNEs. Moreover, a significant portion of these savings may accrue to parties other than New York's former NYNEX customers. At the same time, it would be equally unreasonable to assume that none of these savings affect the cost of supplying UNEs in New York.

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[14] See *1998 Annual Report*, Bell Atlantic Corporation, Investor Relations, New York, NY 10036.

[15] See the testimony of Kevin O'Quinn on behalf of Bell Atlantic - New York, Cases 95-C-0657, 94-C-0095, and 91-C-1174, December 22, 1999, p. 10.

Q. DOES THIS REPLY TESTIMONY IDENTIFY SPECIFIC INSTANCES IN WHICH UNE COSTS ARE FALLING RATHER THAN RISING IN A WAY THAT WOULD SUPPORT BA-NY'S PROPOSED ELEMENT PRICES?

A. Yes. For example, we show below not only that BA-NY's claimed switch UNE costs substantially exceed forward-looking economic costs, but that current switching rates exceed BA-NY's costs by 70% or more. We similarly show that the current statewide average loop rate is 2.35 times BA-NY's costs. Again, even if one chooses to ignore the inconsistencies and misapplications inherent in BA-NY's model-based cost estimates, one must ask whether or not the results of these modeling efforts square with observable reality. In many cases, they simply do not. For example, as we show below, the BA-NY switching cost calculations produce results that are completely contradictory to the general observation that switch prices are declining and are expected to decline further because of improvements in microprocessor technology.

Q. TO THE EXTENT THAT MATURE COMPETITION IS EVER ACHIEVED IN NEW YORK'S LOCAL EXCHANGE MARKETS, IS THERE REASON TO EXPECT THIS COMPETITION WILL FURTHER AFFECT THE COST OF SUPPLYING UNES?

A. Yes. In virtually every industry where effective competition has replaced regulatory oversight as the

guiding force, costs have fallen dramatically. Thus, if the sort of competition foreseen in New York actually comes to fruition, we may expect most costs - including the cost of supplying UNEs to continue to fall. This pattern of competition-induced cost cutting was observed in the market for long-distance and in markets for airline, railroad, and truck transportation.[16] Indeed, had engineering-based models been used to estimate forward-looking costs in any of these industries prior to the introduction of effective competition, the resulting cost projections would have almost certainly been too high. Competition not only affected day-to-day operations within these industries, it routinely and fundamentally altered entire production processes in ways that dramatically reduced costs.

Q. WOULD YOU SUMMARIZE YOUR CONCLUSIONS AS TO WHETHER OR NOT BA-NY'S PROPOSED UNE PRICES ARE JUSTIFIED BASED ON LEGITIMATE ECONOMIC GROUNDS?

A. Yes. There are only two legitimate circumstances that would justify the price increases BA-NY is seeking. The price increases are desirable only if the cost of providing network elements in New York have escalated rapidly over

[16] For example, Surface Transportation Board data reveal that real, output-adjusted railroad operating expenses fell by 27% between 1985 and 1993. See Surface Transportation Board R-1 Reports, Schedule 410.

the past three years or if the Commission established prices that were significantly below forward-looking efficient costs in 1997. The evidence suggests that neither justification is valid. If anything, costs appear to have declined in the past three years and we have not observed the behaviors that would be predicted if current UNE rates are below efficient costs. Thus, I am left to conclude that BA-NY's proposed UNE prices are motivated by something other than a legitimate economic need.

Q. HAVE CIRCUMSTANCES CHANGED RECENTLY THAT MIGHT INDUCE BA-NY TO SEEK UNE PRICES THAT EXCEED THE EFFICIENT COSTS OF PROVIDING NETWORK ELEMENTS?

A. Yes. On December 22, 1999 Bell Atlantic received authority from the FCC to offer in-region long-distance services to its New York customers. This entry into in-region long-distance significantly escalates the potential rewards to behaviors that limit the ability of rival long-distance sellers to offer local service. At the same time, Bell Atlantic's success before the FCC largely removes the incentives to cooperate with UNE purchases.

Q. HOW HAS THE REINTEGRATION OF BA-NY ALTERED ITS INCENTIVES TO COOPERATE WITH LOCAL EXCHANGE COMPETITORS IN NEW YORK?

A. The Telecommunications Act of 1996 seeks to promote competition in local exchange markets. It does so by

fashioning three alternative paths for new competitors to enter local markets. Each of these paths, but especially the path of entry through the purchase of UNEs, requires the cooperation between the RBOC and the new entrants. In exchange for this cooperation, once it has made a public-interest showing, the RBOC is permitted to re-enter the in-region interLATA market.

This process has often been referred to as a "carrot and stick" approach. The carrot of re-entry into long-distance was held out as a reward for RBOC cooperation with new local exchange competitors. When BA-NY was permitted to reintegrate into in-region interLATA toll provision, it effectively ate the carrot. Now, having digested its reward, BA-NY has reduced incentives to maintain its cooperative posture toward enabling and maintaining local competition.

Q. DOES THE ALTERATION OF INCENTIVES, AND BA-NY'S POTENTIAL BEHAVIOR IN LIGHT OF THESE ALTERED INCENTIVES, HAVE ANY IMPLICATIONS FOR THE DEVELOPMENT OF COMPETITION IN NEW YORK?

A. Competition in New York's local telephone markets - where it exists at all - is both new and fragile. Certainly, if historical standards are applied, BA-NY may be

characterized as dominating these markets. Even prior to the FCC's Section 271 decision, BA-NY had an economic incentive to inflate UNE costs in order to produce element prices that would dissuade entry into local New York markets and help preserve its market dominance. In the wake of the Section 271 decision, however, a second and very powerful incentive exists for over-representing UNE costs. If BA-NY is able to extract revenues from local market entrants that exceed the actual efficiently-incurred cost of UNE supply, it can dissuade local entry and also use its dominance in local markets to corrupt the effective competition that exists in the long-distance market. This is true even if a potential rival in long-distance is more efficient.

A simple example can illustrate the problem. Suppose that BA-NY's cost of self-supplying its UNE platform is $20 per month, but that it is able to charge local market rivals $25 for the same platform. Also assume that the rival is able to provide long-distance services at a cost of $0.09 per minute. While BA-NY's cost of long-distance services is $0.10 per minute. A customer using 300 minutes of long-distance each month would be able to purchase bundled local and interexchange services from Bell Atlantic for $50 per

month ($20 + 300x$0.10), while the rival seller would only be able to offer similar services at a price of $52 per month ($25 + 300x$0.09). Moreover, should Bell Atlantic choose to offer its bundled local and long-distance services at a price of $51 per month, it could preclude the market participation of a more efficient rival *and* generate supra-competitive profits in the process.

Q. IF THE COMMISSION SANCTIONS UNE PRICES THAT EXCEED THE EFFICIENTLY-INCURRED COSTS OF PROVIDING THESE ELEMENTS, WHAT WILL BE THE LIKELY OUTCOME IN NEW YORK?

A. Ultimately, New York's telecommunications users are likely bear higher prices for both local and long-distance services than would be evidenced under effective competition. In the case of traditional local service, the nascent competition that exists in some New York markets would be stifled and in the case of long-distance, the effective competition that currently generates benefits for New York customers could be measurably damaged.

Q. WHAT COSTING PRINCIPLES SHOULD BE USED IN DEVELOPING UNE COSTS?

A. There are clearly defined and widely accepted costing principles that should guide the development of UNE prices in New York. These principles are best summarized by the

Total Element Long-Run Incremental Cost (TELRIC) methodology developed as guidance by the FCC for implementing the 1996 Telecommunications Act.[17] There is, quite frankly, very little purpose in re-acquainting this Commission with these costing principles, given that it has demonstrated both a thorough understanding of the TELRIC methodology and a consistent willingness to apply it.

Q. HOW WOULD YOU SUMMARIZE YOUR INTERPRETATION OF BA-NY's PROPOSED INCREASES TO UNE PRICES?

A. The parties to the current proceeding are providing the Commission with useful, albeit voluminous, technical information regarding BA-NY's costs for providing unbundled network elements. It is important, however, that the assessment of this information yield results that are reconcilable with readily observable realities and that square with the most fundamental of economic theories. Mathematical results must lend themselves to a credible story or they should be discarded. There is much to be gleaned from engineering-based costing models, but when such models yield results that are contrary to the most simply formed expectations, we must worry.

[17] FCC 96-325, CC Docket Nos. 96-98, 95-185, August 8, 1996.

BA-NY contends that its requested UNE price increases are necessary, but this is only true if one of two conditions exist. The requested increases are only justified if the initial rates established by the Commission in 1997 were too low or if the legitimate cost of supplying network elements has increased precipitously over the past three years. Neither justification would seem to apply. If the initial UNE prices were far too low, the observed purchase of these elements should have observably harmed the financial performance of BA-NY. This has not occurred. Likewise, the suggestion that UNE supply costs have increased markedly simply does not square with reported cost data, the regulatory framework under which BA-NY's local rates are governed, the expected outcomes of the NYNEX merger, and the experience of other telecommunication providers in New York. The failure of the legitimate defenses for the requested UNE price increases becomes even more troubling when one realizes that these requests come immediately on the heels of an FCC decision that markedly increases the potential rewards from inflating UNE costs. The common sense coupling of these two facts paints a scary prospect for New York's telecommunications users.

III BA-NY COST MODEL OVERVIEW

Q. BRIEFLY DESCRIBE THE BA-NY COST STUDY.

A. In addition to the 425 plus page BA-NY Panel Testimony, the BA-NY cost study posted to the BA-NY website is comprised of approximately 125 individual spreadsheet files consuming over 34 million bytes of computer storage space. In addition, a number of large, complex and proprietary Telcordia programs were used and produced by BA-NY. Despite its sheer mass, the study itself is surprisingly short on details. In total, the BA-NY study produces claimed costs for a total of seven hundred and five UNEs. As demonstrated below, each of BA-NY's claimed UNE costs is overstated.

Q. PLEASE PROVIDE AN OVERVIEW OF THE ORGANIZATION OF THE BA-NY COMPUTERIZED STUDY DOCUMENTATION.

A. Overall the 100 plus computer files are organized logically in folders that correspond with the Panel testimony exhibit numbers. The files generally bear names that provide some level of insight to the function of each file. Notwithstanding the facial appearance of organization, BA-NY's study is not user-friendly since it is difficult to work with individual files for purposes of conducting a detailed examination and analysis. For example, in

contrast to the AT&T/MCI WorldCom UNE 2 Cost Study, which is comprised of a series of integrated modules that work in concert to flow changes to input values through to the final results, the BA-NY spreadsheets are a set of independent analyses in which the results from one file become the inputs to the next file in the sequence. Unfortunately, however, BA-NY's files are not linked electronically. This means that a change to an input as simple as (and as susceptible to change) as the cost of capital requires a combination of manual recalculations of a number of individual spreadsheets and then "cutting and pasting" the output from one sheet to the next. This process is further complicated by the presence of multiple copies of the input datasets within individual spreadsheets. In extreme cases, the input dataset used by the spreadsheet has been placed by BA-NY in a section of the worksheet that is hidden from view, while the dataset that is clearly in view is not referenced at all by the spreadsheet formulas. Thus, it is possible to paste values to what appears to be the appropriate location and to have those inputs go unrecognized. In short, separate and apart from its major substantive deficiencies shown in detail below, BA-NY's cost submission is cumbersome and non-user-friendly. If BA-NY's intent was to build impediments to

the parties' ability to revise the study as part of a rigorous analytical examination, it has accomplished that task.

Q. CAN YOU PROVIDE AN EXAMPLE OF THE DIFFICULTIES ASSOCIATED WITH MAKING A CHANGE TO THE BA-NY MODELS?

A. Yes. To change the cost of capital used in the loop cost calculations requires the modification of no fewer than four different BA-NY Excel workbooks. Briefly, the necessary steps are as follows:

1) Locate the correct input cells for the cost of capital components (i.e., debt financing rate, percent debt, equity financing rate and percent equity) which are found on the sheet labeled "Sect 3.3" of the Excel workbook "PART_H_SECT_3&5_MISC&SUPPORT.xls." Make the appropriate change and follow the spreadsheet formulas to find the new result. For this workbook, the results are located in the sheet labeled "Exhibit."

2) The revised results from step 1) become the inputs to the workbook "PART_H_SECT_2.3_CAPITAL.xls." To effect the change, the results from step 1) need to be copied and pasted as values into the "Input Values" sheet of this file. Again, the revised results are carried forward to another sheet labeled "Exhibit" in the new file.

3) The results from step 2) then need to be carried forward to the sheet "WP_13" of the workbook "PART_H_SECT_2.2_DEAVERAGED.xls." Again the procedure is to copy the results from step 2) and paste them as values to the new worksheet. The revised results are then displayed in the sheet labeled "EXHIBIT-GEOG_EX_2.xls" of this file.

4) Finally, the results from step 4) are carried forward to the "Factors" sheet of the BA-NY Link Cost Calculator, which is itself an Excel workbook named "WP_PART_A-1_SEC1-4_LINK-REV.xls," at which time the model can be

rerun to assess the impact of the change in the cost of capital on loop costs.

Q. IN ADDITION TO ITS FORMAL COST STUDY SUBMISSION, DID BA-NY ALSO PRODUCE A "SIMPLIFIED" MODEL THAT IT CLAIMS REPLICATES A DISCRETE SUBSET OF ITS DETAILED COST STUDY RESULTS?

A. Yes, BA-NY alludes to, but does not rely upon "a cost study development environment" that it has named BACost. BA-NY describes BACost as "a spreadsheet building tool that facilitates structured and efficient development of new studies, updates to existing studies, production of consistent and professional documentation and the analysis and comparison of studies" -- capabilities notably absent from the cost study that it actually submitted and is relying upon in support of its claimed UNE costs.

Q. WHY DID BA-NY NOT USE BACOST IN ORDER TO DEVELOP ITS CLAIMED UNE COSTS IN THIS PROCEEDING?

A. According to BA-NY, BACost is still in the development stages. While apparently it is BA-NY's intent to ultimately use BACost as its primary costing tool in each of its jurisdictions, it is clearly not yet ready for serious consideration as a viable cost tool. Moreover, this fact is not changed whatsoever by BA-NY's claim that the current version of BACost has successfully replicated its claimed UNE costs for switching features and switch

ports. Indeed, BA-NY's claim is virtually meaningless as support for BACost's analytical integrity. BA-NY explains that the SCIS model is an integral component of the BACost model. Yet, since SCIS is intended to output investments for switch features and ports, it is a simple matter to multiply those investments by an annual cost factor to produce results. As demonstrated below, however, the SCIS data provided by BA-NY' is itself inherently unreliable and BA-NY's claimed switching costs do not withstand analysis.

Q. SHOULD THE WORK-IN-PROGRESS BACOST MODEL PLAY ANY ROLE WHATSOEVER IN THE COMMISSION'S CONSIDERED EVALUATION OF BA-NY'S UNE COST CLAIMS IN THIS CASE?

A. No, BA-NY's reference to BACost is nothing more than a distraction that should be ignored completely for purposes of an examination and analysis of BA-NY's claimed UNE costs. First, by BA-NY's own admission, the BACost model is not yet completed. Second, the model is in the process of being calibrated to replicate the current BA-NY UNE cost claims, which, as demonstrated below, are grossly overstated. Third, BA-NY appears to be taking a "trust us" approach to the model's integrity by offering the model as a "client/server application" that resides in part on a personal computer and interacts continually with two relational databases maintained on a BA server. Finally,

if at some point in the future, BA-NY actually completes its development of BACost, understanding the intricacies of the model will likely require discovery of BA-NY, as well as workshops and other informational presentations. Until that time, BACost is simply a non-issue. For now, it has no bearing on this case.

Q. HOW DO THE INPUTS USED BY BA-NY IN ITS UNE COST STUDY COMPARE WITH THE INPUTS THAT IT RELIED UPON IN THE PHASE 1 COST PROCEEDING?

A. While we have not performed an exhaustive comparison, there are a number of input assumptions made by BA-NY in this proceeding that differ considerably from the inputs for the same components used by BA-NY in the Phase 1 cost proceeding (Case Nos. 95-C-0657, 94-C-0095, 91-C-1174). What is troubling is that BA-NY has not provided any explanation of why these input assumptions would change.

Q. CAN YOU PROVIDE AN EXAMPLE?

A. Yes. A good example is house and riser cable fill. In the Phase 1 cost proceeding, BA-NY used a fill assumption for copper house and riser cable of 65%. In this phase, however, the house and riser cable fill has dropped to 40%. Nothing in BA-NY cost study documentation suggests that house and riser design characteristics have changed over the last few years. It appears rather that BA-NY is taking

a view that this UNE update is simply an opportunity to increase UNE rates.

Q. PLEASE DESCRIBE THE MAJOR COMPONENTS OF BA-NY'S STUDIES UNDERLYING ITS CLAIMED UNE COSTS.

A. BA-NY's local loop studies include the four basic types of loops addressed in Phase 1 of Case 95-C-0657 (two- and four-wire analog loops, and two- and four-wire digital loops), as well as high-capacity "entrance facilities" (such as the DS3 loops considered in Phase 3 of Case 95-C-0657), dark fiber loops, subloops (including house and riser), and ADSL/HDSL-compatible loops.

BA-NY's switching studies address both local and tandem switching. Separate claimed costs are presented for ports, switch usage, and features.

BA-NY also submitted claimed costs for a range of unbundled interoffice transport offerings. In addition, it presented proposed rate development for certain interconnection rates based on its claimed switching and transport costs (referred to in the testimony as "derived rates"), such as proposed Meet Points A and B intercarrier compensation rates as well as proposed rates for signaling systems and associated databases.

BA-NY's submission also addressed claimed cost-based NRCs for provisioning element combinations, as well as additional recurring charges applicable to combinations (i.e., the EEL Testing Charge, formerly known as the EEL Connection Charge) beyond the sum of the recurring charges for the constituent elements.

Finally, BA-NY has included claimed costs for certain "subloop" components. These include conduits, ducts, and rights-of-way and house and riser building cable.